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Talking Points for PFIAB

Global Economic Trends

Although the first function of intelligence is to provide warning of future problems, and this means we usually emphasize the dangers and negative features of the world scene, I would like to start on a positive note. I believe that the fundamental trends in the world economy are positive, in the sense that they present excellent opportunities for improvements in economic performance and welfare.

- o While no one can measure the overall rate of technological change, it is evident that massive, indeed revolutionary, technological developments are taking place in microelectronics, composite materials and other industries which can revolutionize production processes, product characteristics, communications, and the way people live.
- o Barring a major war, big commodity shocks--such as the massive oil price increases of the 1970s--are unlikely, at least during the remainder of the decade.
- o Most important, a fundamental shift is evident in economic policies not only in the US, but also in Western Europe and much of the developing world.
 - Western governments are giving a high priority to holding down inflation, instead of accommodating increased wage and credit demands.
 - The role of government in the US and West European economies, after rising rapidly during the 1970s, is beginning to be reduced, and there appears to be a growing political consensus that further reductions are essential.
 - An increasing number of developing countries are becoming disenchanted with socialist/statist economic policies because of the evident failure of such policies over the past 20 years, and are slowly permitting the role of private enterprise and of free markets to expand.

These favorable trends are not, of course, problem-free. Some of them require very difficult adjustments. Moreover, the repercussions of some serious problems of the 1970s will be felt for many years. Finally, new problems that we can not yet discern may arise.

Technological trends always cut both ways, and the remainder of this decade will be no exception.

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- o The high tech revolution not only builds new industries, but also destroys old ones. For example, the secular growth of demand for steel and many other metals is slowing greatly. This hurts especially the established steel and other metals industries in industrial countries, contributing greatly to structural unemployment. It also hurts the LDC exporters of metals and metal ores, the prices of which tend to be lower.
- o Modern technology--cheap transportation and rapid communications, as well as greater opportunities to produce efficiently on a relatively small scale--also facilitates the internationalization of industries, such as automobiles, and other areas of manufacturing and services. Foreign sourcing of components in automobile production, for example, involves not only the main industrial countries, but also a growing number of LDCs.

Although the basic trends in energy look pretty favorable, there could be some serious problems, possibly resulting from over-optimism.

- o Conventional wisdom now expects oil markets to be soft and oil prices to fall or at least to be stable well into the 1990s. As a result, any sense of urgency in developing alternative energy sources has disappeared. Although the conventional wisdom may be right, there are some worrisome possibilities.
- o With real oil prices down for several successive years, and world economic growth perhaps improving somewhat during the remainder of the decade, the growth of oil demand may increase. Moreover, government as well as private efforts to stimulate conservation are slackening.
- o The result of greatly intensified efforts to find new oil during the past several years have been disappointing. The odds on finding the large new oil producing areas that will be needed to offset depletion in the longer term appear smaller than they once did.
- o Although several OPEC countries have a great deal of unused productive capacity, need money, and consequently are looking for any opportunity to increase oil production, they may eventually prefer to restrict production in order to raise prices rather than to produce to capacity.

The potentially positive economic trends could be severely disrupted by financial crises and constraints, especially the overhang of and fallout from the debt problem of developing countries.

- o Many developing countries, including the largest ones, such as Brazil, Mexico, and Argentina, will face a heavy debt service burden for years to come.

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- o With interest payments taking 25 to 50 percent of export earnings, the debtor countries will encounter major difficulties unless exports grow very rapidly indeed. They are doing so in some countries, like Brazil, but we worry about what may happen if Western economic growth should slow in 1985-86, or, worse yet, if there should be a new recession.
- o The debtor countries have already suffered severe economic austerity because of the debt problem, with real expenditures per capita having fallen 15 to 25 percent since 1980-81. Even if economic growth resumes soon, several countries are unlikely to make up the lost ground for several years, perhaps in some cases until after 1990.
- o In these circumstances, not many debtor countries would endure any increase in austerity, and in almost all of them political pressures to resume rapid economic growth are building.
- o So far economic austerity has not bred much political instability, but political pressures have increasingly forced debtor country governments to resist economic policy conditions imposed by the creditors, especially the IMF.
- o Consequently, debtor-creditor relations are tending to become more confrontational, with the Argentine issue being the most serious and immediate. If general economic conditions are favorable, compromises can probably be worked out, although not without substantial losses to many Western banks. But if world economic conditions should deteriorate, debtor-creditor confrontations could lead to a severe financial crisis, the resolution of which would probably require major reforms.

On the trade front also we see both positive and negative trends.

- o The world market is continuing to broaden, because of increased economic specialization among the industrial countries and increased participation of a growing number of developing countries in the market for manufactured goods and for services.
- o On the negative side, the industrial countries are erecting new protectionist barriers, in the form of voluntary export restraints, quota systems, etc., designed at least to limit the pain of adjustment to major changes. These protectionist barriers, should they continue to proliferate, could greatly slow the process of structural change in the industrial countries, and seriously reduce the potential of developing countries for export growth and diversification and for successfully coping with the debt service burden.

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- o There is also a risk that financial stringencies will continue to stimulate government-sponsored counter-trade arrangements in the LDCs. Although these arrangements help to cope with temporary difficulties, if they expand and persist they would hinder the efficient development of world trade.

I would like to touch on some of the possible questions these trends appear to raise for our national security.

- o Structural change and internationalization of industries mean that more and more elements of our basic and machinery industries are going off-shore. This is even true in high technology industries, such as microelectronics. This process, although in the main both inevitable and economically healthy, raises some questions:
 - How do we deny or limit the transfer of military-related technology to potential enemies when more and more of this technology is produced off-shore?
 - How do we ensure a sufficient domestic industrial base to meet mobilization needs in plausible wartime situations?
 - How do we ensure that our military R&D continues to produce and use state-of-the-art technology in peacetime, when foreign producers have become technological leaders in more and more areas?
- o Although economic austerity has not yet created much political instability, if bad economic conditions should continue, they could contribute to serious instability in countries, such as Mexico, where the US has an enormous stake.

I have not yet mentioned the USSR or the other Communist countries. The reason is that they are only marginal actors on the international economic scene.

- o The USSR is capable of greatly increasing its exports of natural gas to Western Europe in the 1990s if alternative gas sources are not developed.
- o Soviet grain purchases have increased this year, and will probably remain large in the future.
- o But apart from oil and gas exports, grain imports, and arms sales, the USSR trade with the free world is very small. About two-thirds of Soviet exports to non-Communist developing countries consist of arms and military support equipment. The remainder is less, for example, than the exports by South Korea alone to the Third World.

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- o We see little chance of a change in coming years. Indeed, the broad trend away from socialist/statist policies in Third World countries will tend to reduce Soviet trade opportunities and probably also Soviet political influence.
- o The point is that Moscow cannot significantly influence world economic trends through economic actions. It can, however, take advantage of political openings or opportunities for military intervention.

Finally, I would like to mention some forthcoming intelligence products which address various aspects of these global economic trends.

- o An NIE on The Political Repercussions of the Debt Crisis in Major LDCs is in coordination.
- o An NIE, Trends in Foreign Free World Advanced Technologies, is scheduled for next spring.
- o A DDI Study, "Economic Change and the Third World," is nearing completion.
- o A joint NIC/DDI study on the security implications of industrial trends is being prepared.
- o And various studies on macroeconomic, industrial, financial and trade trends are in process.